

STATE TAX COMMISSION

of

AFFIDAVIT OF MAILING

State of New York }

SS.:

David Parchuck, being duly sworn, deposes and says that he is an employee of the State Tax Commission, that he is over 18 years of age, and that on the 6th day of April, 1984, he served the within notice of Decision by certified mail upon Union Dime Savings Bank, the petitioner in the within proceeding, by enclosing a true copy thereof in a securely sealed postpaid wrapper addressed as follows:

Union Dime Savings Bank
1065 Avenue of the Americas
New York, NY 10018

and by depositing same enclosed in a postpaid properly addressed wrapper in a post office under the exclusive care and custody of the United States Postal Service within the State of New York.

That deponent further says that the said addressee is the petitioner herein and that the address set forth on said wrapper is the last known address of the petitioner.

Sworn to before me this
6th day of April, 1984.

Daniel Parbuch

Samuel A. Spurgeon
Authorized to administer oaths
pursuant to Tax Law section 174

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition :
of :
Union Dime Savings Bank : AFFIDAVIT OF MAILING
for Redetermination of a Deficiency or Revision :
of a Determination or Refund of Franchise Tax on :
Banking Corporations under Article 32 of the Tax :
Law for the Years 1974, 1975 & 1976. :

State of New York }
ss.:
County of Albany }

David Parchuck, being duly sworn, deposes and says that he is an employee of the State Tax Commission, that he is over 18 years of age, and that on the 6th day of April, 1984, he served the within notice of Decision by certified mail upon John A. Pileski, the representative of the petitioner in the within proceeding, by enclosing a true copy thereof in a securely sealed postpaid wrapper addressed as follows:

John A. Pileski
Peat, Marwick, Mitchell & Co.
345 Park Avenue
New York, NY 10022

and by depositing same enclosed in a postpaid properly addressed wrapper in a post office under the exclusive care and custody of the United States Postal Service within the State of New York.

That deponent further says that the said addressee is the representative of the petitioner herein and that the address set forth on said wrapper is the last known address of the representative of the petitioner.

Sworn to before me this
6th day of April, 1984.

David Parchuck

James A. Pileski
Authorized to administer oaths
pursuant to Tax Law section 174

STATE OF NEW YORK
STATE TAX COMMISSION
ALBANY, NEW YORK 12227

April 6, 1984

Union Dime Savings Bank
1065 Avenue of the Americas
New York, NY 10018

Gentlemen:

Please take notice of the Decision of the State Tax Commission enclosed herewith.

You have now exhausted your right of review at the administrative level. Pursuant to section(s) 1090 & 1468 of the Tax Law, a proceeding in court to review an adverse decision by the State Tax Commission may be instituted only under Article 78 of the Civil Practice Law and Rules, and must be commenced in the Supreme Court of the State of New York, Albany County, within 4 months from the date of this notice.

Inquiries concerning the computation of tax due or refund allowed in accordance with this decision may be addressed to:

NYS Dept. Taxation and Finance
Law Bureau - Litigation Unit
Building #9, State Campus
Albany, New York 12227
Phone # (518) 457-2070

Very truly yours,

STATE TAX COMMISSION

cc: Petitioner's Representative
John A. Pileski
Peat, Marwick, Mitchell & Co.
345 Park Avenue
New York, NY 10022
Taxing Bureau's Representative

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition
of
UNION DIME SAVINGS BANK
for Redetermination of a Deficiency or for
Refund of Franchise Tax on Banking Corporations :
under Article 32 of the Tax Law for the Years :
1974, 1975 and 1976.

DECISION

Petitioner, Union Dime Savings Bank, 1065 Avenue of the Americas, New York, New York 10018, filed a petition for redetermination of a deficiency or for refund of franchise tax on banking corporations under Article 32 of the Tax Law for the years 1974, 1975 and 1976 (File No. 24749).

A formal hearing was held before Frank W. Barrie, Hearing Officer, at the offices of the State Tax Commission, Two World Trade Center, New York, New York, on April 18, 1983 at 1:25 P.M. with all briefs to be submitted by July 25, 1983. Petitioner appeared by Peat, Marwick, Mitchell & Co. (John A. Pileski, CPA). The Audit Division appeared by John P. Dugan, Esq. (William Fox, Esq., of counsel).

ISSUE

Whether petitioner, for purposes of computing the alternative tax on dividends under Tax Law section 1455(b)(2), properly netted out penalties for premature withdrawals from interest credited to its depositors.

FINDINGS OF FACT

1. On May 19, 1978, the Audit Division issued three notices of deficiency against petitioner, Union Dime Savings Bank (hereinafter, "Union Dime"), asserting additional corporate franchise taxes due under Article 32 of the Tax

Law for the years 1974, 1975 and 1976 of \$1,084.23, \$1,222.54 and \$1,229.45, respectively, plus interest thereon. The statements of audit adjustment dated March 23, 1978 issued against petitioner explained that petitioner may not net out interest penalties in computing dividend tax.¹

2. Petitioner is a savings bank organized under the laws of this state. It reported entire net income (loss) for 1974, 1975 and 1976 of (\$2,700,033.43), \$651,568.89 and \$403,785.49, respectively.

3. Petitioner computed its corporate tax liability under Tax Law section 1455(b)(2), the alternative minimum tax. Petitioner took the interest credited in each category of account after netting out any penalties imposed, and multiplied it by a factor, the numerator of which was the three and one-half percent statutory rate and the denominator of which was the contract rate for that account category, to obtain the interest which would have been credited if interest had been computed at the statutory rate.

Petitioner's computations for 1974 were as follows:

<u>Dividends and Interest Paid</u>	<u>Rate</u>	<u>Base Amount of Dividends</u>
\$36,241,587.35	5 1/4%	\$24,161,058.23
180,303.85	5 3/4	109,750.17
8,448,584.77	6	4,928,341.12
3,095,420.72	6 1/2	1,666,765.00
2,777,217.02	6 3/4	1,440,038.45
96,252.91	7	48,126.46
5,540,280.62	7 1/2	2,585,464.29
354,669.80	7 3/4	160,173.46
493,608.83	8	215,953.86
5,391,179.30	8 1/4	2,287,166.98
<u>\$62,619,105.17</u>		<u>\$37,602,838.02</u>

¹ The statements of audit adjustment incorrectly noted that the alleged tax deficiencies were imposed under Article 9-A of the Tax Law.

Petitioner's computations for 1975 were as follows:

<u>Dividends and Interest Paid</u>	<u>Rate</u>	<u>Base Amount of Dividends</u>
\$36,841,942.34	5 1/4%	\$24,561,294.89
23,961.51	5 3/4	14,585.27
2,126,232.22	6	1,240,302.13
4,416,103.15	6 1/2	2,377,901.70
4,263,408.37	6 3/4	2,210,656.19
98,008.06	7	49,004.03
9,638,775.81	7 1/2	4,498,095.38
2,226,917.42	7 3/4	1,005,704.64
594,645.52	8	260,157.42
5,777,901.37	8 1/4	2,451,230.88
<u>\$66,007,895.77</u>		<u>\$38,668,932.53</u>

Petitioner's computations for 1976 were as follows:

<u>Dividends and Interest Paid</u>	<u>Rate</u>	<u>Base Amount of Dividends</u>
\$ 4,365.35	2 %	\$ 4,365.35
38,276,383.22	5 1/4	25,517,588.81
13,449.24	5 1/8	9,184.85
44.64	5 1/4	29.76
999.21	5 1/2	635.86
148,793.55	5 3/4	90,569.99
657,379.49	6	383,471.37
152,400.76	6 1/4	85,344.43
5,357,296.95	6 1/2	2,884,698.36
3,970,872.58	6 3/4	2,058,970.97
114,093.30	7	57,046.65
13,577.27	7 1/4	6,554.54
12,734,728.23	7 1/2	5,942,873.17
4,862,484.00	7 3/4	2,195,960.52
622,440.20	8	272,317.59
6,192,258.92	8 1/4	2,627,018.93
<u>\$73,121,566.91</u>		<u>\$42,136,631.15</u>

4. Petitioner netted out penalties for premature withdrawals of \$92,934.23, \$80,607.67 and \$101,327.54 for 1974, 1975 and 1976, respectively, from interest credited to its depositors. According to petitioner, such interest penalties were excluded from petitioner's base amount of dividends and interest at an average rate of 6 percent for 1974 and 1975 and at an average rate of seven and one-half percent for 1976. The Audit Division determined that the base amount of dividends and interest for 1974 and 1975 should be increased by applying a

factor of .58333² against the penalties for such years and added \$54,211.32 and \$47,020.87 to the dividend and interest base amounts for 1974 and 1975, respectively. As a result, the Audit Division increased petitioners base amounts from \$37,602,838.02 to \$37,657,049.34 for 1974, and from \$38,668,932.53 to \$38,715,953.40 for 1975. The Audit Division increased the base amount of dividends and interest for 1976 by applying a factor of .46667³ against the penalties for such year and added \$47,286.52 to the dividend and interest base amount for 1976 thereby increasing it from \$42,136,631.15 to \$42,183,917.67.

5. For each of the years at issue, petitioner filed a Form 1120, U.S. Corporation Income Tax Return, on which it claimed a deduction for dividends paid depositors of \$36,242,748.84, \$36,841,942.34 and \$38,141,841.91 for 1974, 1975 and 1976, respectively, and a deduction for interest expense on time accounts of \$26,470,822.89, \$29,246,561.10, and \$35,081,052.54 for 1974, 1975 and 1976, respectively. Petitioner disregarded early withdrawal penalties imposed on its depositors in calculating such deductions.⁴

² This factor was determined by dividing the three and one-half percent statutory rate by the average rate of six percent by which petitioner had excluded the penalties from its computations noted in Finding of Fact "3", supra.

³ This factor was determined by dividing the three and one-half percent statutory rate by the average rate of seven and one-half percent by which petitioner had excluded the penalties from its computations noted in Finding of Fact "3", supra.

⁴ The totals for dividends paid and interest expense were \$62,713,571.73, \$66,088,503.44, and \$73,222,944.45 for 1974, 1975 and 1976, respectively. In computing its tax on dividends and interest for Article 32 purposes, petitioner only reported \$62,619,105.17, \$66,007,895.77 and \$73,121,566.91 for 1974, 1975 and 1976, respectively, differences of \$94,466.56, \$80,607.59 and \$101,327.54 for 1974, 1975 and 1976, respectively. For 1975 and 1976, the penalties for early withdrawal are equal to such differences. For 1974, only \$92,934.23 of the \$94,466.56 is for penalties for early withdrawal. The remaining \$1,532.33 is for interest on mortgagor's escrow deposits.

6. Petitioner's "Rules and Regulations for Term Accounts" provides as follows:

"Withdrawals prior to maturity of term accounts may be made only with the consent of the Bank, subject to the following penalties except in the case where an owner dies or is declared legally incompetent.

For Certificates opened before July 1, 1979, FDIC Regulations require that the interest rate be lowered to the then current passbook rate and that 90 days interest at that rate be forfeited."

The penalty is withheld from the depositor's account balance and the remaining amount is distributed to the depositor upon his premature withdrawal. In other words, interest credited to a depositor's time deposit account is subject to forfeiture unless the account is maintained to its complete term.

7. If the petitioner erroneously credits \$1,000.00 to a depositor's account instead of \$100.00 and later corrects such error, the Audit Division would not include the \$900.00 credited in error in the pool of interest against which petitioner's franchise tax is calculated. Petitioner argues that, similarly, the Audit Division should not include interest, which a depositor is not entitled to because of premature withdrawal, in such pool of interest. The Audit Division's response to this argument is that penalty, which is an expense to the depositor for having withdrawn funds prior to some agreed future date, is separate and distinct from interest which has been credited to the account of a depositor and that the netting of a penalty against interest comes only after interest has been credited.

CONCLUSIONS OF LAW

A. That Tax Law section 1451 provides that every banking corporation exercising its franchise or doing business in New York is subject to a tax computed under Tax Law section 1455.

B. That petitioner calculated its tax liability for the years at issue under the alternative minimum tax, Tax Law section 1455(b)(2), as effective during the years at issue, which provided as follows:

"For a savings bank and savings and loan association, two percent of the interest or dividends credited by it to depositors or shareholders during the taxable year, provided that, in determining such amount, each interest or dividend credit to a depositor or shareholder shall be deemed to be the interest or dividend actually credited or the interest or dividend which would have been credited if it had been computed and credited at the rate of three and one-half per cent per annum, whichever is less."

C. That there is no provision whatsoever in Article 32 for netting out penalties for premature withdrawal of funds from interest credited to depositors in determining the base against which the alternative minimum tax is calculated.

D. That petitioner's analogy to an error in crediting interest to a depositor's account, as noted in Finding of Fact "7", supra, is inexact. The crediting of interest and the subsequent forfeiture of interest, as the result of the imposition of a penalty for premature withdrawal, does not void the initial crediting of interest. In contrast, the correction of an error in crediting interest does, in fact, void the initial erroneous crediting of interest.

In fact, during the years at issue, petitioner under I.R.C. Section 591 took a full deduction for interest credited and dividends paid, disregarding early withdrawal penalties⁵ as noted in Finding of Fact "5", supra.

⁵ Petitioner is required to include interest in its gross income which its depositors forfeit because of premature withdrawal of funds in the taxable year in which it exercises its right to such forfeited interest. Treas. Reg. 1.591-1(b). The depositor must include all interest credited (including the forfeited interest) in his gross income under I.R.C. § 61. The loss of interest resulting from the premature withdrawal of funds (which is deductible under I.R.C. § 165) may then be deducted from gross income to determine adjusted gross income under I.R.C. § 62.

E. That in American Savings Bank f.k.a. Franklin Savings Bank v. State Tax Commission, ___ N.Y.S.2d ___ (Supreme Court, Albany County Special Term, September 9, 1983), Justice Connor determined that there is "but one reasonable method for computation of petitioner's tax liability under this statute [Tax Law §1455(b)(2)]". Such method was described in the following two steps:

"1. Compute the average daily deposit liability for the tax year in all accounts which earned at a rate greater than 3.5%, without regard to interest actually earned, paid, accrued or forfeited in these accounts.

2. Multiply this amount by 3.5%. The result is the tax base for purposes of computation of the alternative minimum tax."

The netting out of penalties from interest becomes irrelevant under such method.

However, an appeal is pending in such case, and we do not choose to overrule our decision in the Matter of Manhattan Savings Bank, State Tax Commission, June 26, 1981, in which we held that the netting out of penalties from interest in calculating tax under Tax Law §1455(b)(2) is not permissible.

F. That the petition of Union Dime Savings Bank is denied.

DATED: Albany, New York

STATE TAX COMMISSION

Rudolph W. Cline
PRESIDENT

Frank R. Koenig
COMMISSIONER

Mark J. [Signature]
COMMISSIONER